United States Court of Appeals

for the Second Circuit

APPELLEE'S BRIEF

Affidavit

75-6133

To be argued by
V. PAMELA DAVIS

United States Court of Appeals

FOR THE SECOND CIRCUIT

Docket No. 75-6133

UNITED STATES OF AMERICA,
Plaintiff-Appellee,

—v.—

PAUL R. BROWN and UNITED STATES TELEPHONE CO.,
Defendants-Appellants.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF FOR PLAINTIFF-APPELLEE

ROBERT B. FISKE, JR.,
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Statement of the Case

Defendants-Appellants Paul R. Brown ("Brown") and United States Telephone Company ("the company")* appeal from a judgment entered in the United States District Court, Southern District of New York on October 23, 1975 pursuant to the memorandum decision of the Hon. Henry Werker dated October 6, 1975 granting judgment to the United States in the amount of $1,522,-454.40. The memorandum decision contains the Court's findings of fact and conclusions of law and is reproduced in the joint appendix ("J.A.") at 167a-173a.

The defendants were charged with violations of section 1592 of Title 19, United States Code, which authorizes

* During the relevant times defendant Brown was an officer of the defendant company, acting on its behalf.

the seizure and forfeiture to the government of all goods imported into the United States pursuant to false or fraudulent statements to the United States Customs Service ("Customs"). Where, as here, forfeiture is unavailable*, the statute provides for a penalty in the amount of the value of the merchandise.

Prior to trial, the government moved for partial summary judgment on the issue of the falsity of the documents submitted to Customs by defendants for 36 separate entries of merchandise. This motion, based upon the *res judicata* effect of a previous criminal action, was granted on July 11, 1975 with respect to 32 of the entries.** On August 13, 1975 a one day non-jury trial was held before the Hon. Henry Werker on the issue of the use of false or fraudulent documents for an additional 18 entries as well as the issue of the value of all 50 entries, each entry encompassing hundreds of individual items of merchandise for a total of individual items of merchandise for a total of approximately 47,400 telephones.

Judge Werker found that the 18 entries which had not been the subject of partial summary judgment had also been imported through the use of false and fraudulent documents. (J.A. 171a). The Court further found that the value of the merchandise imported in all 50 entries within the meaning of section 1592, Title 19, United States Code was $1,522,454.50. (J.A. 173a). The District Court found no basis for the claim of the defendants that a cause of action as to 15 of the 50 entries was barred by the applicable statute of limitations. (J.A. 171a).

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* As the fraud was not discovered until sometime after importation, the merchandise had already been released to the defendants.

** Defendants had challenged four of the entries as barred by the statute of limitations. The District Court therefore reserved judgment as to those four until trial.

Defendants appeal solely from the findings of the District Court as to the value of the merchandise and the statute of limitations.

Issues Presented

1. Where the defendants are the exclusive importers and wholesale distributors of unusual merchandise, is the domestic value of such merchandise, within the meaning of 19 U.S.C. 1592, properly determined by reference to the price at which the defendants themselves offered the merchandise for sale?

2. Was the submission by the defendants of false invoices to Customs for the importation of merchandise known to the United States more than five years before the institution of this action, *i.e.*, knowledge prior to July 23, 1966?

Statute and Regulation

Section 1592, Title 19, United States Code, forbids the use of false or fraudulent statements in connection with the importation of merchandise into the United States. The statute authorizes forfeiture of the merchandise as a civil penalty for violations. Where, as here, the fraud is not discovered until after the imported merchandise has been released by Customs to the importer, the statute authorizes collection of a penalty in the amount of the value of the merchandise.

This statute is wholly independent of those sections of Title 19, United States Code which provide for the collection of Customs duties and which further provide for the valuation of merchandise for that purpose. Valuation of merchandise for purposes of section 1592 is the subject of a Customs regulation published at 19 C.F.R. § 162.43:

§ 162.43 Appraisement.

(a) *Property under seizure and subject to forfeiture.* Seized property shall be appraised as required by section 606, Tariff Act of 1930, as amended (19 U.S.C. 1606). The term "domestic value" as used therein shall mean the price at which such or similar property is freely offered for sale at the time and place of appraisement, in the same quantity or quantities as seized, and in the ordinary course of trade. If there is no market for the seized property at the place of appraisement, such value in the principal market nearest to the place of appraisement shall be reported.

(b) *Property not under seizure. With respect to property not under seizure the basis for the claim for forfeiture value or for assessment of penalty is the domestic value as defined in paragraph* (a) *of this section,* except that the value shall be fixed as of the date of the violation. In the case of entered merchandise, the date of the violation shall be the date of entry, or the date of the filing of the document, or the commission of the act forming the basis of the claim, whichever is later. (Textual emphasis supplied).

The statute of limitations for the commencement of this type of action is set forth in section 1621, Title 19, United States Code:

§ *1621. Limitation of actions.*

No suit or action to recover any pecuniary penalty or forfeiture of property accruing under the customs laws shall be instituted unless such suit or action is commenced within five years after the time when the alleged offense was discovered: *Provided,* that the time of the absence from the United States of the person subject to such penalty or forfeiture, or of any concealment or absence of the property, shall not be reckoned within this period of limitation.

Statement of Facts

The parties stipulated * that defendants were consignees of decorator telephones ** imported from Japan between 1964 and 1968. The parties further stipulated that Brown, acting on behalf of the company, caused decorator telephones to be imported pursuant to invoices submitted to Customs and introduced at trial as government exhibits ("GXs") 1-50, (J.A. 8a) and that he caused the decorator telephones to be paid for by the submission of invoices to various banks for payment via letters of credit. The letter of credit invoices differed from the invoices submitted to Customs and were received into evidence as GX's 1A-50A (J.A. 9a).

The District Court compared the set of invoices labeled GX 1-50 with the set labeled GX 1A-50A and found them identical but for the listing of the unit price of the telephones.*** The Court found that the figures shown as the price of the telephones on the invoices submitted to Customs were substantially lower than the figures shown as the price of the telephones on the invoices presented to the banks for payment by the defendants to their foreign manufacturer for the merchandise pursuant to the letters of credit. (J.A. 168a).

The District Court therefore found that the invoices submitted to Customs for the importation of the telephones

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* The stipulation was introduced into evidence at trial as Joint Exhibit 1 (J.A. 8a).

** Decorator telephones, the merchandise which is the subject of this action, are specially molded telephone receivers which were made in a variety of unusual styles and colors. Illustrations of some of these appear at J.A. 159a and 161a.

*** Examples of corresponding invoices from GX 1-50 and GX 1A-50A are set forth at J.A. 136a, 137a, and 140a, 141a. Both invoice prices for all the merchandise are set forth in columns six and seven of the charts which were GX 70-74 set forth at J.A. 162a-166a.

were false with respect to the listed purchase price of the telephones (J.A. 168a). This finding is not here disputed.

John O'Brien, a former Customs employee, testified concerning the history of the dealings between Customs and the defendants over the decorator telephones. Mr. O'Brien had been responsible for processing the importation of the telephones when shipments commenced in 1964 (J.A. 57a-58a). He identified GX 1-50, already in evidence, as the invoices submitted to Customs for the importation of the telephones (J.A. 58a) but stated that the second set of invoices, with the higher prices, (GX 1A-50A) had never been submitted to nor even seen by him (J.A. 58a-59a). He described a meeting which took place in middle or late 1964 between himself, his assistant and defendant Paul Brown. The meeting had been called by Mr. O'Brien to discuss a royalty charge, listed on the invoices submitted to Customs, which has no direct relevance to the issues of this action. At the close of the meeting, Mr. Brown promised to provide Customs with additional information about the royalty charge but never did so. (J.A. 60a-62a).

Mr. Brown gave no indication at this meeting that the second set of invoices existed (GX 1A-50A) nor did he advise Customs of the discrepancy between the price which was shown on the invoices submitted to Customs and the price which defendants were actually paying for the telephones (J.A. 72a-74a) as reflected on the invoices submitted to the banks to obtain payment on the letters of credit.

Although Brown's recollection of this meeting differed somewhat, he did not rebut O'Brien's assertion that there was no indication to Customs as the result of this meeting that defendants were engaged in a double-invoicing scheme (J.A. 79a-83a).

Mr. O'Brien testified that for the remainder of 1964 through 1965 the only communications between Customs and the defendants were telephone follow-ups to Mr. O'Brien's requests for information from defendants (J.A. 62a-63a). Nevertheless, no information was forthcoming (J.A. 62a).

In approximately October of 1965, O'Brien forwarded to a Customs representative in Japan a routine inquiry concerning the decorator telephones (J.A. 63a). It was O'Brien's expectation that the Customs representative, Roy Nakajima, would interview the seller listed on the invoices, Greenhill-Kato, and would report back on such matters as the make-up and price of the telephone in Japan (J.A. 65a). The Customs representative, Mr. Nakajima, interviewed individuals at Greenhill-Kato in Japan on July 26, 1966 (GX 76). As a result of this interview Agent Nakajima reported the existence of the double-invoicing scheme (GX 76). Thus, July 26, 1966 is the earliest date that knowledge of the false or fraudulent nature of the documentation by which defendants were importing telephones could be attributed to the government. The complaint was filed on July 23, 1971 within five years of the discovery of the defendants' scheme to defraud the United States.

Defendants offered no evidence in support of their contention that the government knew of the fraud prior to five years before the filing of the complaint. Mr. Brown testified that unidentified "letters from Japan" somehow gave evidence that Customs was concerned with double-invoicing in early 1965 (J.A. 86a) but he neither elaborated nor produced the letters.*

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* Clearly, the District Court gave no credibility to this statement.

The evidence as to the value of the merchandise was offered through the testimony of Harry Haroian, employed by Customs as an Import Specialist (J.A. 10a-11a). In his capacity as a Customs Import Specialist, Mr. Haroian performed the appraisal of the decorator telephones (J.A. 16a).

Mr. Haroian gave as the test of domestic value for purposes of section 1592, Title 19, United States Code:

> "The price at which [merchandise] was freely offered and sold in the market, in the usual quantities here in the United States" (J.A. 16a).

Mr. Haroian testified that the best evidence available to the government of the price at which this merchandise was freely sold in the usual quantities was the defendants own price lists (GX 51-55) * which had been obtained from defendant Paul Brown. (J.A. 16a-18a). These lists showed the wholesale price at which the company offered the telephones for sale. (J.A. 32a). Upon cross-examination Mr. Haroian stated that efforts had been made on several occasions to obtain more information from the defendants but that none was forthcoming (J.A. 37a-40a, 45a).

Haroian's appraisal of value for most of the merchandise was arrived at by the simple process of taking the model name from the invoice, checking it against the price list appropriate for the time of importation and determining the price for that model at that time. (J.A. 18a-19a, 23a). The results of this process were listed in the seventh column of the charts introduced into evidence as GX's 70-72.** (J.A. 22a-23a).

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* These lists are reproduced at J.A. 155a *et seq.*

** These charts are reproduced at J.A. 162a-164a.

Mr. Haroian testified that defendant Brown had not provided price lists appropriate in time for all models (J.A. 23a). Two alternative methods were therefore utilized. (J.A. 23a-24a).

For the model "Antimony", Mr. Haroian testified that he used the price at the appropriate time for the model "Duchess." (J.A. 23a). The parties' pre-trial stipulation, Joint Exhibit 1, at paragraph 8 stated that the "word 'antimony' when used in connection with a decorator telephone is synonymous and interchangeable with the term 'classique.'" As the price introduced into evidence as the price of antimony models is the same as the price of the classique models (GX 72 at J.A. 164a), and as this is consistent with the stipulation of the parties, it is probable that Mr. Haroian misspoke, using the term duchess mistakenly for the term classique.

The second alternative method was used for approximately half of the merchandise, all of which were the model "US-4". Mr. Brown had not provided information as to the price at the time of importation at which this very popular model was sold; therefore, Mr. Haroian determined the value by reference to the price at which merchandise was purchased. (J.A. 23a-25a). As it was the government's contention that the price which appeared on the invoices given to the banks for payment by letter of credit was the actual price paid for the merchandise, as opposed to the fraudulent price on the invoices submitted to Customs, the price was taken from the second set of invoices, GX 1A-50A (J.A. 23a-25a, 35).*

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* Using this method, one-half of the telephones (45%) were valued at $165,490 or approximately 10% of the total, an indication of substantial undervaluation in defendants' favor.

Mr. Haroian stated that he would have considered evidence that substantial quantities of telephones had in fact been sold at a lower price than that shown on the price lists (J.A. 49a) if it had been available. However, he stated that repeated efforts to obtain such information from defendants, the sole possessors of such information, had not been successful despite repeated assurances that such evidence existed. (J.A. 37a-39a, 44a-45a).

Defendant Brown was the only witness for the defense. He testified that it was his usual business procedure to use a 1.2 to 1.5 markup over the company's purchase price of the telephones (J.A. 112a-114a), meaning a multiplication of the purchase price by 220% to 250% (J.A. 119a-121a).

Applying this rule of thumb at the lower or 1.2 level to the price found by the Court to be the company's true purchase price—the second invoice price—yields a result of $1,438,379.22 (J.A. 173a).

Brown testified that he had not been able to sell all of the telephones involved in this action (J.A. 113a) but did not state how many were not sold nor did he give any estimate of the price of those which did sell. He testified that the wholesale prices used by Haroian were not accurate (J.A. 115a) but did not say how they were inaccurate or to what extent. Finally, he testified that the price lists which he had provided to the government were used as a negotiating point with large stores (J.A. 121a-122a) and as a means of maintaining the price level with smaller customers (J.A. 122a). Defendants' counsel conceded that the defense had no computation as to the value of the telephones to offer into evidence. (J.A. 123a, 129a-130a).

ARGUMENT

POINT I

The District Court's finding as to value is based upon the appropriate legal standard and is fully supported by the evidence in the record.

The penalty to be imposed in an action pursuant to section 1592, Title 19, United States Code is the domestic value of the merchandise imported by means of false statements. 19 C.F.R. § 162.43(b), *United States* v. *Nephrite Jade*, 325 F. Supp. 986 (W.D. Co. 1970). The definition of value as set forth in the regulation, 19 C.F.R. § 162.43, and as applied by the valuation expert, was the price at which the merchandise was freely offered and sold in the usual quantities in the United States.

For ordinary merchandise, value is determined by making inquiries at the appropriate market place, wholesale or retail depending upon the first sale following importation. The merchandise in this case, however, is highly specialized and, more important, imported and offered for sale exclusively by the defendants * who created and controlled the wholesale market price.**

Mr. Haroian, the government's valuation expert, did not contend that domestic value could not be determined by

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* Defendant Brown testified that telephones similar to those involved here were not manufactured in the United States at the relevant time (J.A. 83a). He said prior to his commencing importation there had been some manufactured in Denmark (J.A. 83a). However, by 1964, all such telephones being imported were from Japan and all showed a royalty paid to defendant Paul Brown. (J.A. 59a).

** Indeed, as acknowledged in appellants' brief, the defendants attempted to exert control over the resale price. See brief of Defendants-Appellants at 7.

reference to the actual price which defendants exacted from large and small retailers. (J.A. 37a-38a). The only source for that information is the defendants' sales records. Nonetheless, the defendants refused to supply this information despite years of continuing demands from the government both before and after the institution of suit. Indeed, defendants response to such requests remained consistent up to and including the final moments of the trial when defendants' counsel stated:

> Your Honor, relative to what you said before the adjournment, we do not have now a list prepared that would show your Honor the actual sale in the United States that would correspond to each and every entry here.
>
> * * * * *
>
> And if your Honor wants, or if your Honor will permit, Mr. Brown can try to get out all this correspondence tonight and see if we can get invoices that would relate directly to these charts, and I could supply them to the Court; that is, if your Honor wants it. (J.A. 129a-130a).

Needless to say, no such list, no such invoices and no such correspondence was ever produced.

In the absence of evidence from the defendants of actual sales price, and with the possibility of comparable sales of equivalent merchandise precluded by the defendants' monopolistic market position, the government presented as evidence of value the defendants' price lists for the appropriate periods of time which defendants conceded were utilized for the purpose of making offers of sale to their customers. The defendants attempted to impeach their own price lists by a generalized statement from Mr. Brown that not all the telephones had sold for the price

on the price lists.* No documentary evidence was offered to support Brown's oral testimony.

The defendants, and only the defendants, had possession of the documents which showed to whom telephones were sold and at what price. If, indeed, such documents would have supported Mr. Brown's unadorned generality, why were they never produced? If effective rebuttal existed to the government's evidence of value, why was such rebuttal not made? In the absence of any corroboration, this testimony by Brown was "discounted" by the District Court. (J.A. 172a).

The challenges in appellants' brief to the government's definition and evidence of domestic value are premised upon distortions of the testimony and the applicable regulation which border on the frivolous.

It is claimed that the government's valuation was not based on the sales price for "the same quantities seized" as required by the regulation. The individual entries or "quantities seized" contained an average of several hundred of each model. The government's valuation was based upon price lists which defendant Brown testified were used for large customers, Macy's being one such customer referred to in testimony. Surely it is reasonable to assume that large customers purchasing wholesale would place orders for at least several hundred of each

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* The effect of this testimony is further vitiated by the circumstance that almost half of the imported telephones (45%) were the so-called "US-4" model which did not appear on the price lists for the appropriate time. Mr. Haroian was therefore forced to use, not the sale price, but defendants' own purchase price as the index of value. As this figure does not include either profit or overhead, indeed, as it does not reflect what Mr. Brown testified was a 120-150% markup, the merchandise was substantially undervalued in defendants' favor.

model. The price lists themselves state that special handling charges are added for small orders. Indeed, the requirement of the regulation that value be assessed for sales in the quantities seized disqualifies much of defendant Brown's testimony of sporadic sales of certain models. The government's valuation was premised on precisely the price at which "the quantities seized" were sold.

The second challenge is to that part of the regulation which states that the merchandise be appraised for its value "at the place of appraisement." * The plain meaning of this phrase is that, should the price for the merchandise in New York differ from the price of the same merchandise at other ports, *e.g.*, Miami, Los Angeles, or should transportation costs be a factor, the New York price prevails. The government's evidence complied with this requirement. The value was taken directly from the defendants' price lists for the merchandise they were importing and selling in New York. The company's headquarters was in Manhattan. Macy's was referred to as a customer. The price lists state that the terms are "F.O.B. Our Warehouse".

Finally, the claim is made that Mr. Haroian did not appraise the merchandise as of "the date of entry." ** On the contrary, Mr. Haroian testified that the price of each model was taken only from a price list which bore a date corresponding to that of entry. It was the government's compliance with the requirement that merchandise

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* The use by the government's witness, Mr. Haroian, of the phrase "in the United States" meant only that use of the domestic price, and not the price in the place of manufacture, is required The New York price is required by the regulation and the New York price was used with no modification or adjustment.

** The regulation requires appraisement as of the date of "violation"; here, the date of entry.

be valued as of the date of entry which resulted in the necessity of resorting to the deliberate undervaluation of using the defendants' purchase price and not its sales price for the US-4 models for which information appropriate to date of entry was not available. In this instance, the defendants' failure to respond to discovery worked substantially in their favor.

The government was required to offer proof of "the price at which such or similar property is freely offered for sale at the time and place of appraisement . . ." (19 C.F.R. § 163.42). The government offered proof of the price at which defendants themselves offered their own merchandise for sale in New York. The proof was geared to the date of the violation as required.

In rebuttal the defendants, with all of the relevant information in their exclusive possession, offered only sporadic, generalized statements, none of which directly confronted the government's proof and some of which supported it. The amount of the judgment should be affirmed.

POINT II

The causes of action as to all fifty entries were timely pursuant to the applicable statute of limitations.

Appellants below asserted the affirmative defense of the statute of limitations as a bar to judgment based upon the 15 entries which arrived in the United States between October 28, 1964, and April 23, 1966.

The applicable statute of limitations is set forth at section 1621 of Title 19, United States Code. It requires that the action be commenced within five years of the date of discovery by the government of the fraud. The

complaint was filed on July 21, 1971. In order to prevail, the defendants must have established that the government had knowledge of the fraud prior to July 23, 1966. Instead, the trial established that the government first discovered the fraud by happenstance on July 26, 1966.

The fraud in this action was double-invoicing, the preparation of an internally consistent set of documents which are presented to Customs and which include a false invoice at a lower price than the actual price as stated on the real invoice.

Naturally, the real invoice must be presented to the bank issuing the letter of credit in order for the importer to make payment to his foreign seller.

Even if it were desirable for Customs to check with every financial institution with respect to the financing of every importer, such a practice would hardly be feasible. Here, the report of Customs Agent Roy Nakajima (GX 76) showed that the discovery of the fraud occurred only because the foreign seller itself prepared both sets of invoices at the defendants' direction and an employee of the seller so stated in a routine interview with Mr. Nakajima. The testimony at trial was that this report was received in New York in October of 1966. The Customs employee in New York responsible for the processing of this merchandise testified that he had no knowledge of the fraud prior to the receipt of this report.

The assertion that a cause of action is barred by the statute of limitations is an affirmative defense pursuant to Rule 8(c) of the Federal Rules of Civil Procedure. The burden of proof is therefore on the defendants to demonstrate knowledge on the part of the government prior to five years before the filing of the complaint. *Fruit and Vegetable Packers Warehousemen Local 760*

v. *Morely*, 378 F.2d 738, 746 (9th Cir. 1967); *Kallman* v. *Stalty*, 1 F.R.D. 726 (N.D. Iowa 1941).

The only proof at trial on the issue of the statute of limitations was offered by the government. There is no evidence whatsoever in the record to support a finding of knowledge of the fraud on the part of the government prior to five years before the filing of the complaint.

Furthermore, even if the assertion in appellants' brief that a due diligence requirement must be read into the statute of limitations is correct,* the very nature of a double-invoicing scheme is such that no suspicion would be aroused absent specific knowledge on the part of Customs of the higher price on the invoices presented to the banks. This is particularly so where, as here, the merchandise is unique and Customs had no experience with the usual price of such items and no competitive items with which the price could be compared. Customs did indeed have questions concerning certain of the charges listed on the invoice, questions which the defendants were always promising to answer but never did. It was the diligence of Customs in checking these items that eventually lead to the discovery of the fraud. (J.A. 63a).

Defendants bore the burden of establishing knowledge of the fraud on the part of Customs prior to July 23, 1966. They did not do so. The District Court's denial of defendants' affirmative defense of violation of the statute of limitations was proper.

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* The wording of the applicable statute of limitations, 19 U.S.C. 1621, was amended in 1935 to change five years from the time "such penalty or forfeiture occurred" to five years from the time "the alleged offense was discovered" suggesting that no such due diligence requirement was intended.

CONCLUSION

The District Court's judgment should be affirmed.

Dated: New York, New York
April 23, 1976

Respectfully submitted,

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te of New York)
nty of New York) ss

Marian J. Bryant being duly sworn,
oses and says that she is employed in the Office of the
ted States Attorney for the Southern District of New York.

That on the
d day of April, 1976 she served ~~a~~ two copys of the
nin Brief for Plaintiff-Appellee

placing the same in a properly postpaid franked envelope
ressed:

Alvin Miller, Esquire
342 Madison Avenue
New York, New York 10017

And deponent further
s she sealed the said envelope and placed the same in the
l chute drop for mailing in the United States Courthouse Annex,
St. Andrews Plaza, Borough of Manhattan, City of New York.

Marian J. Bryant

rn to before me this
d day of April, 1976

Ralph I. Lee

RALPH I. LEE
Notary Public, State of New York
No. 41-2292838 Queens County
Term Expires March 30, 1977